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# The Philippine Rural Economy: A Crop of Problems

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An Intelligence Assessment

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EA 85-10124  
July 1985

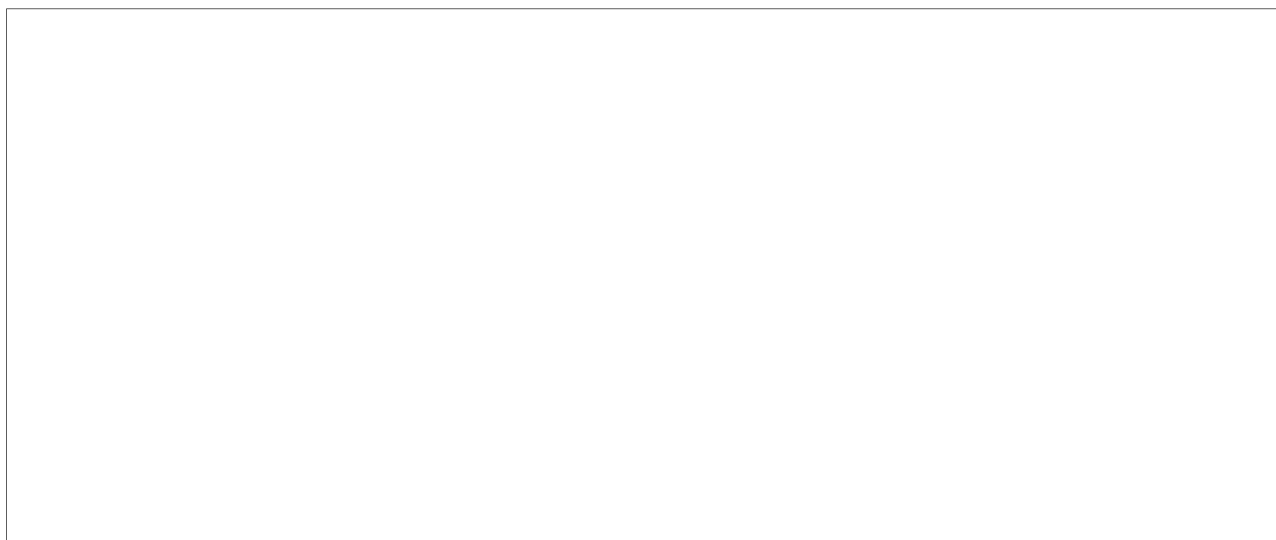
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# **The Philippine Rural Economy: A Crop of Problems**

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**An Intelligence Assessment**

This paper was prepared by [ ] Office  
of East Asian Analysis. [ ]

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**The Philippine Rural Economy:  
A Crop of Problems**

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**Key Judgments**

*Information available  
as of 6 June 1985  
was used in this report.*

Although agricultural output has grown by an average of 4 percent a year since the early 1970s, at least 20 million rural Filipinos live in poverty—defined by the World Bank as an annual income of less than \$160—and their numbers are increasing. The declining national economy since 1981 is largely to blame for depressed rural incomes, but we believe that Manila's rural development programs have contributed to a skewed distribution of rural incomes and landholdings. The programs have bypassed many smallholder farmers and the landless poor while favoring established landowners and, in the case of major export crops such as coconut and sugar, benefited presidential business associates. This trend has increased social tensions in recent years and provided the growing Communist insurgency with ample opportunities to recruit supporters.

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The chronic battle over rural economic policy between Marcos and his critics remains a contest between a comprehensive strategy of reforms and increased investments advocated by Manila's foreign creditors and the government's current "incremental" approach, which combines ad hoc programs with modest reforms. Our analysis suggests that, with a comprehensive strategy—involving among other things breaking up the coconut and sugar monopolies and allowing more competition in selling agricultural products—the country could achieve a 4-percent annual growth rate in agriculture over the next few years and, more important, improve income distribution. We believe this would do much to undercut the appeal of the Communist insurgency if combined with civic action programs. Continuing current policy, on the other hand, will further depress rural living standards.

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On balance, Marcos will probably initiate some of the reforms suggested by aid donors and his domestic critics, but he is unlikely to change markedly his approach toward the rural economy. His recent reorganization of the coconut and sugar monopolies, for example, will do little to improve the lot of the farmer. This suggests that actual policy will strike a compromise between Marcos and his critics—allowing him to satisfy his principal political needs, chiefly assuring adequate financing for the ruling party in coming elections, while keeping foreign assistance flowing.

Even if Marcos were to embrace the comprehensive strategy, the agricultural outlook would show few short-term gains because of the IMF-mandated austerity program that is restricting government spending, the

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lack of managerial talent required to oversee the reform programs, and the normal timelags of several years in implementation. In addition, the Communist insurgents are stepping up economic sabotage and "taxation" of farmers in some parts of the countryside. The majority of rural Filipinos thus will continue to suffer depressed living standards, enabling the Communist Party to continue to win new recruits in the next several years.

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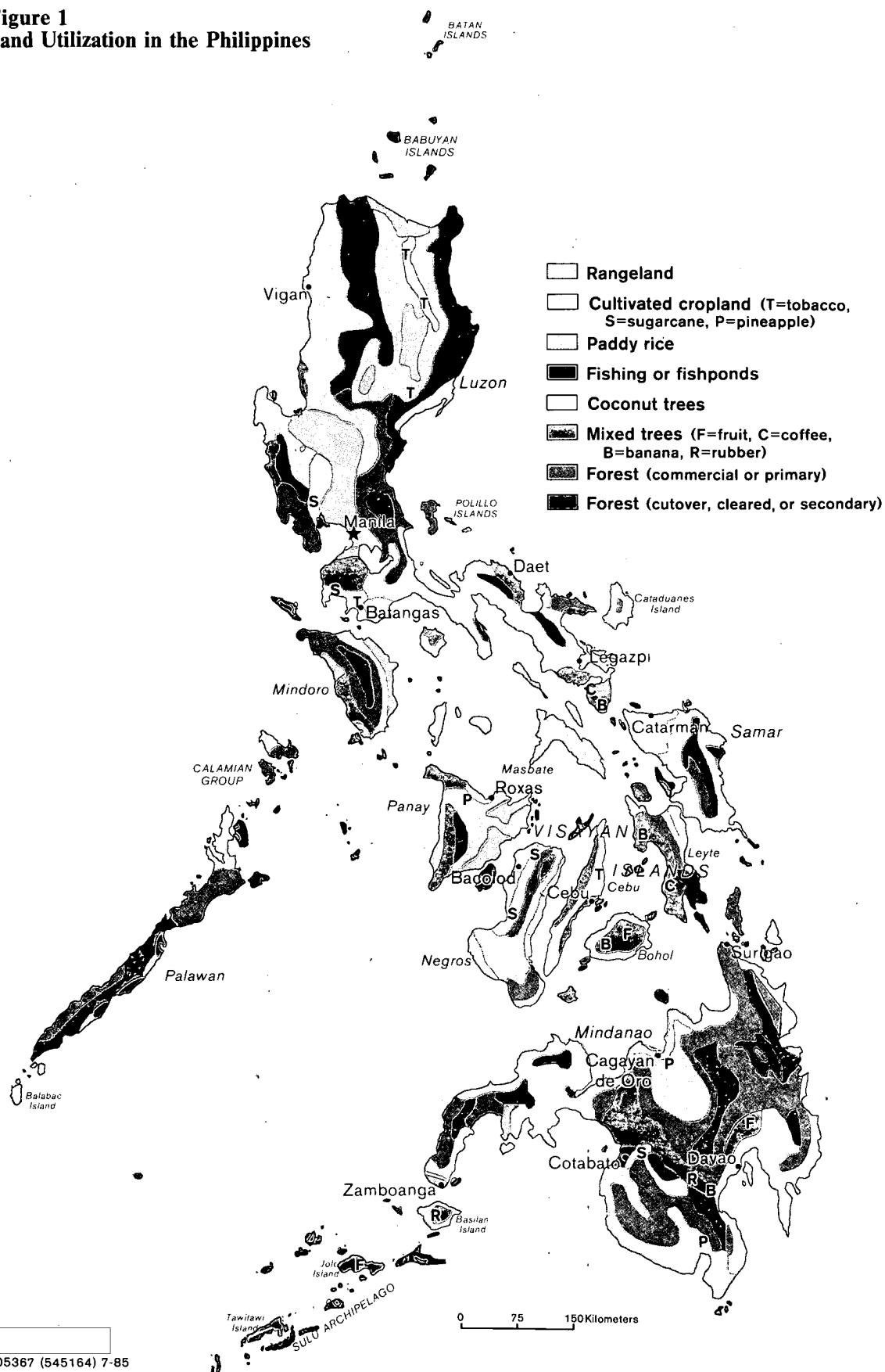
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**Figure 1**  
**Land Utilization in the Philippines**



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## The Philippine Rural Economy: A Crop of Problems

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### Strains in the Countryside

Philippine agriculture has grown at an annual rate of 4 percent since the early 1970s, but these gains have been distributed unevenly in the countryside, where 35 million people live, 60 percent of them in poverty.<sup>1</sup> The manifestations of depressed incomes are not hard to find. According to the World Bank, the level of agricultural wages—adjusted for inflation—fell by half between 1977 and 1981 because of government economic policies that favored urban consumers by depressing agricultural prices. Population growth, increased rural indebtedness, and declining productivity have combined to push rural families off the land or reduce land holdings to a size too small to support a family. As a result, the landless poor are a large and rapidly growing group, accounting for nearly 40 percent of households in rice- and sugar-growing areas. Furthermore, reduced government funding for social services has diminished the quality of life for many, and rural impoverishment is driving many Filipinos into the least rewarding agricultural pursuits, including coastal fishing and marginal upland farming.

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The chief beneficiary of the crisis in the countryside has been the Communist Party of the Philippines (CPP) and its military arm, the New Peoples' Army (NPA). As real rural wages fell and income inequality increased during the late 1970s and early 1980s, for example, the party posted its most dramatic recruitment gains: we believe that the number of NPA regular guerrillas tripled to approximately 16,000 by the end of 1984. We estimate that the Communist-led insurgency has nearly 1 million supporters and that the remote and poorer regions of the country effectively controlled by the NPA contain over 5 million inhabitants.<sup>2</sup>

<sup>1</sup> For purposes of this paper, the poverty line is defined as an annual income of less than 2,950 pesos, or \$160 at the current exchange rate.

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**Table 1**  
**The Philippines: Gross National Product—Components and Growth**

Sector	Percent of GNP, 1983	Growth Rate, 1972-83 (real annual percent rate)
<b>Gross national product</b>	<b>100.0</b>	<b>5.3</b>
<b>Agriculture</b>	<b>25.1</b>	<b>4.1</b>
Crops	15.2	4.8
Rice	3.9	3.4
Corn	1.4	3.1
Coconut	1.3	0.7
Sugarcane	1.1	0
Bananas	2.4	13.4
Other crops	5.1	7.3
Livestock	4.8	5.9
Fishery	4.4	4.5
Forestry	0.7	-8.0

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economic grievances are among the primary causes of Communist Party recruitment gains. Grievances center around land title and rents, property theft, and inadequate government services, according to US Embassy reporting. In recent years thousands of smallholders have reportedly been deprived of their land via outright land grabs—often to expand pineapple or banana plantations—or land title frauds supported by a corrupt local legal system. For example, a 200,000-hectare logging concession granted to Herminio Disini—an associate of President Marcos—displaced thousands of minority families. Villagers also complain about landlords who circumvent agrarian reform regulations to charge high rents, evict tenants, or demand excessive interest rates for production loans.

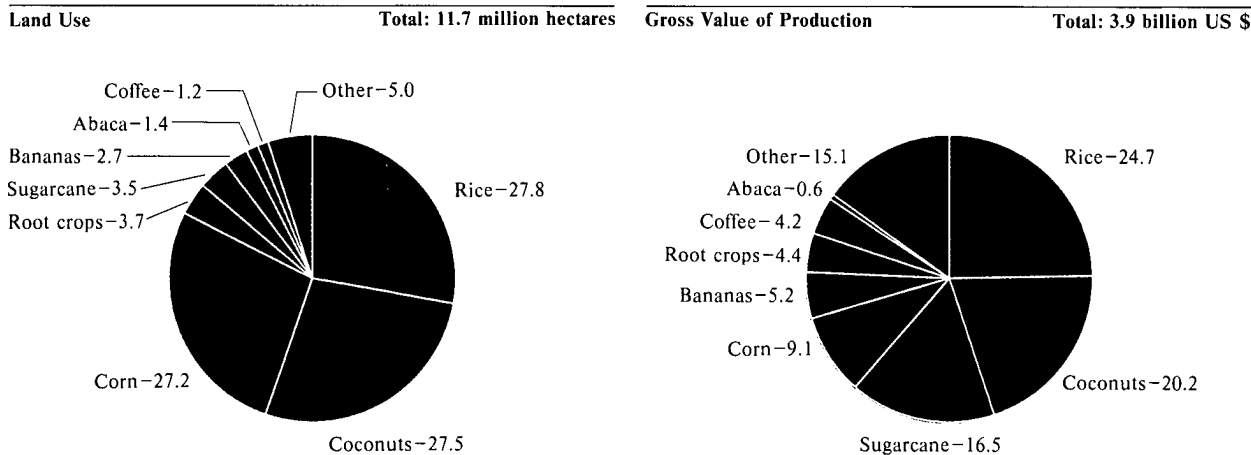
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**Figure 2**  
**The Philippines: Agricultural Crop Production, 1983**



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The NPA's social action program focuses on redressing the grievances of poor farmers, farmworkers, and the landless. Landlords, for example, are encouraged to reduce rents, lower charges for services, and redistribute "surplus" land. In northeastern Luzon, for example, the NPA claims it has reduced or eliminated rent payments for nearly 10,000 farmers, and in southern Negros communal farming is practiced in some NPA-controlled villages.

the NPA's land reform program, combined with deteriorating government control in the countryside, is forcing landlords to abandon farms and retreat to secure towns. Ironically, some landlords reportedly avoid collecting rents from NPA-controlled villages because they fear that government forces will accuse them of being NPA supporters.

The NPA also capitalizes on local economic problems—such as the severely depressed sugar industry in which nearly 250,000 workers on the Visayan island of Negros are being laid off.

the plight of the sugar workers is playing into the hands of the NPA, which has increased its local propaganda efforts and is succeeding

in attracting new recruits. As a result, Negros later this year, in our judgment, has at least an even chance to join Mindanao and several other regions where Communist influence rivals that of the central government in many areas.

#### Manila's Approach to Agriculture

Weak international markets for Philippine agricultural exports have contributed substantially to rural poverty during the last decade, with agricultural prices failing to keep pace with those of manufactured goods. The slide is a result not only of sagging demand abroad but also the development of substitute products for key agricultural goods—in particular, palm oil substitutes for coconut oil products and high-fructose sweeteners for sugar. The result has been that inflation-adjusted prices for sugar and coconut products—the primary cash crops of the economy—last year were, respectively, 30 and 40 percent below the level prevailing in 1973.

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*The Rural Economy at a Glance*

*The Philippines remains a predominately rural society; approximately 60 percent of the population lives in the countryside where agriculture is the dominant economic activity. Viewed from a national perspective, agriculture generates over half of all jobs, 25 percent of gross output, and 40 percent of export earnings. Viewed as the mainstay of the countryside, agriculture—characterized by small family-operated farms—employs two-thirds of the rural labor force and generates nearly half of rural output.*

*Crops—mainly rice, corn, coconut, and sugar—dominate the rural economy, followed by livestock and poultry, fisheries, and forestry. Food crops occupy more land, but in recent years the output of commercial crops has grown more rapidly. Rice—a staple in urban and rural areas—is grown mainly in the lowlands, where irrigation makes two or three annual crops possible. Corn dominates the subsistence farms in the uplands, where the Communist insurgency is most deeply rooted. The typical small farm supplements its primary crop—rice or corn—with other food and cash crops. Sugarcane—grown on large farms and plantations—and coconut are the principal commercial crops, followed by abaca fiber, coffee, and bananas.*

*Although accurate statistics on land tenure are not available, numerous studies indicate that only 15 percent of farming families own full title to their land. In ricegrowing regions, tenants pay up to half their harvest for rent, while landlords in coconut areas collect up to two-thirds of the harvest. In one ricegrowing village of Luzon, over a fifth of*

*agricultural production is paid to landlords residing outside the village—a situation that the Communists exploit.*

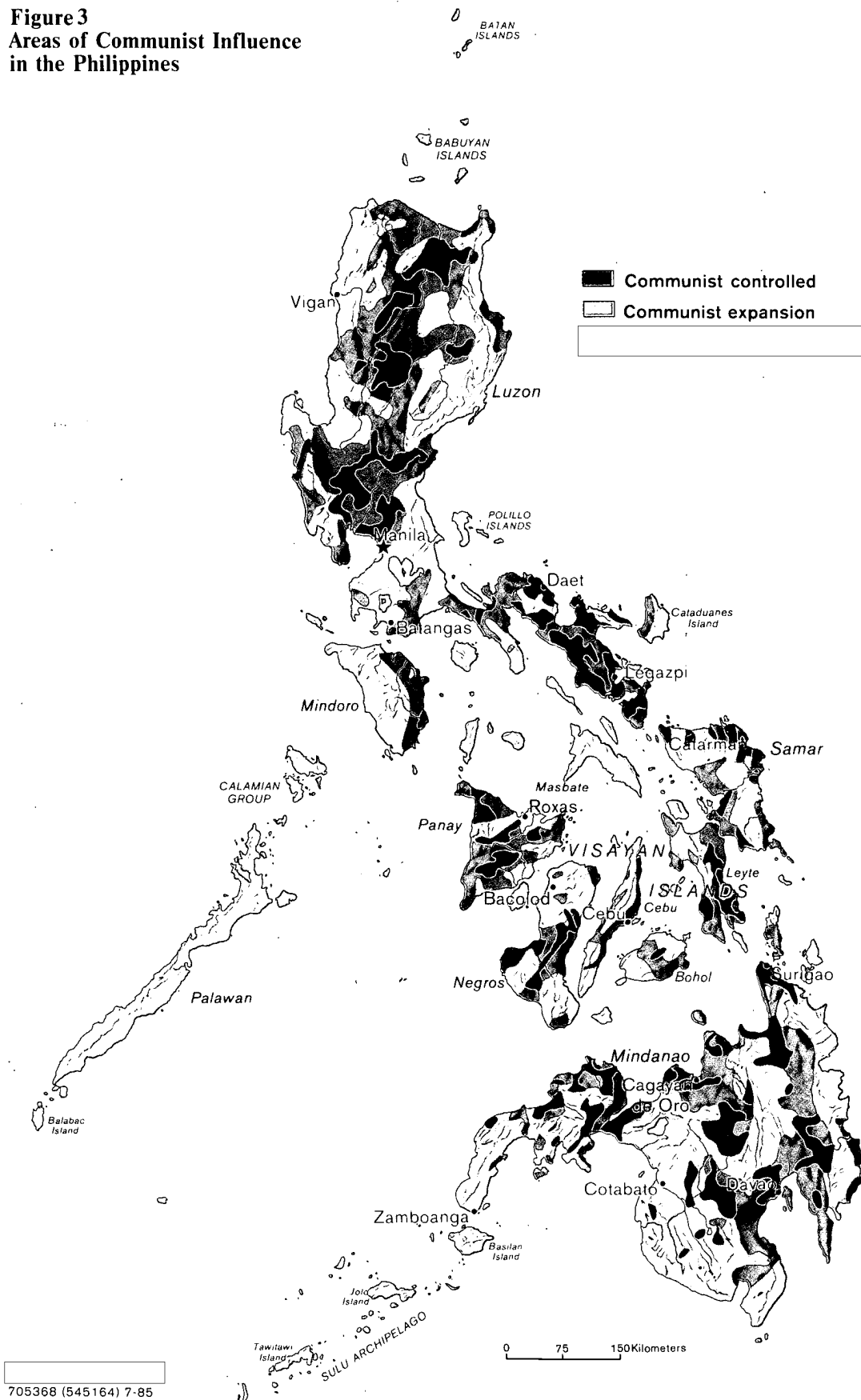
*Agency for International Development studies classify the small village, or “barangay”—typically containing between 100 and 200 households—as the principal economic unit in the countryside. Poor village households—especially those at the edge of subsistence—maintain diverse income sources to moderate fluctuations in their income. About 70 percent of household income is earned from farming, with the balance coming from nonfarm employment and remittances. Landless households, however, are more dependent on outside help, with over a third of purchasing power remitted from relatives. Both farm and landless families work as wage laborers on farms and earn nonagricultural income as weavers or carvers, tricycle drivers, mechanics, vendors, or fishermen.*

*Rural employment patterns differ dramatically in the sugar, banana, and pineapple plantations concentrated on the insurgent-infested islands of Negros and Mindanao. Negros Occidental, for example, produces 60 percent of the nation's sugar. Over half of the province's work force earns its livelihood in the fields, crushing mills, and service industries related to sugar. When sugar earnings slump, as they recently have in Negros, sugar workers become prime targets for recruitment efforts by the left, since they have few alternative income sources.*

*Erratic government policy has often complicated matters. Manila began on the right track during the 1970s when rural development became the centerpiece of the “New Society” President Marcos planned to create under martial law. Manila sought to raise agricultural production with investments in irrigation, high-yielding rice varieties, rural credit programs, and agrarian reform. Indeed, much of the countryside*

*benefits from programs that brought electricity to nearly 15 million rural Filipinos, increased the number of rural roads four times, delivered safe drinking water to hundreds of towns, and initiated primary health care services in 90 percent of the rural villages.*

**Figure 3**  
**Areas of Communist Influence**  
**in the Philippines**



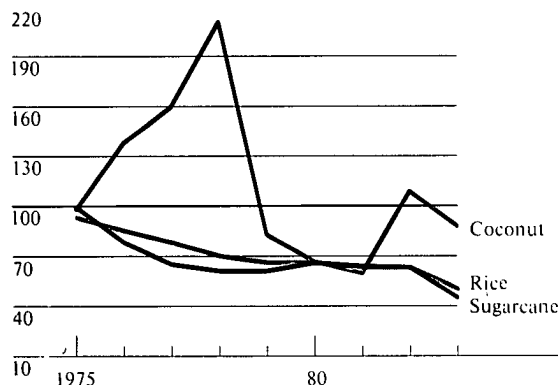
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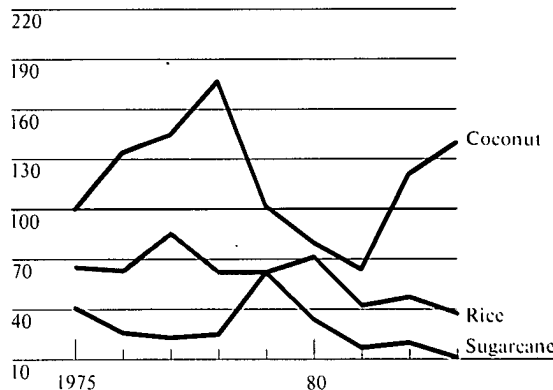
**Figure 4**  
**The Philippines: Index of Real Agricultural Prices, 1976-84**

Index: 1975=100

Prices Received by Farmers<sup>a</sup>



World Market Prices<sup>b</sup>



<sup>a</sup> Prices deflated by Philippine consumer price index.

<sup>b</sup> Prices converted into pesos and deflated by Philippine consumer price index.

Sources: Philippine Government and IMF statistics.

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According to the World Bank, however, Manila paid little attention to inequitable and worsening income distribution or eradicating poverty. Illustrating this contradiction is the country's success in producing surplus rice for export by 1977 at the same time the diet of Filipinos in many rural villages was declining. We believe that land reform, rice promotion programs, and government use of the "pork barrel" underscore Manila's uneven policy track record.

**Land Reform.** Manila's modest land reform policy consists of two parts. Operation Land Transfer allows about 400,000 rice- or corn-growing tenants to purchase land through a 15-year payment program. Operation Leasehold, on the other hand, ensures that up to 600,000 tenants have a written and recorded lease with their landlord, fixing rent payments and tenure rights. According to Philippine Government statistics, about 70 percent of the targeted leasehold participants now have recorded leases, although, in view of the modest scale of the program, this does not involve a large number of farmers.

The agrarian reform program is criticized by Manila's aid donors, Philippine academics, and opposition politicians who believe that it has increased rural poverty and income inequality. The need for land reform is clear; about 5 percent of farmers own over one-third of the land. From the start in the early 1970s, however, the program was limited to rice and corn lands and offered nothing for the landless. Only 14 percent of the country's farmland is included in the program; sugar-, coconut-, and fruit-growing lands, among others, are excluded. According to Agency for International Development (AID) evaluations, farmers are reluctant to risk investing in irrigation or new technologies without land title or a guaranteed leasehold. Furthermore, only one-fifth of the farmers in the transfer program are able to make the required payments, according to the World Bank.

**Table 2**  
**The Philippines: Profile of the Rural Poor**

	Characteristics	Income Sources	Vulnerability
<b>Lowland rice farmers</b>			
Over 30 percent of all rural households; 50 to 60 percent below poverty threshold.	Farm operation is a family enterprise.	Over 70 percent of income—cash and kind—derived from farm; 10 percent from outside employment; 20 percent from remittances. Increasingly diversifying income by seeking off-farm employment, depending on landless laborers to work farm.	Severe cost-price squeeze. Rising input costs and interest rates—aggravated by peso devaluations and IMF-mandated austerity program—outpacing prices paid for crops.
	Majority of poor work less than 2 hectares. Half are tenants; one-third are amortizing owners; one-sixth are full owners.		
	Over 60 percent operate rainfed, not irrigated farms, usually harvesting only one rice crop a year with other crops comprising a smaller second harvest.	Up to 20 percent of cash inflow is borrowed. Up to 30 percent of cash outflow is for loan repayment.	Land tenure not secure and vulnerable to land grabs often upheld by biased court system.
	Low income and growing indebtedness forcing farm families into landless status.		Land fragmentation shrinking size of average farm. Farm-based income falling below poverty threshold.
<b>Rural landless</b>			
At least 25 percent of all rural households; 85 percent are below poverty threshold. Account for 40 percent of households in many ricegrowing regions and 80 percent of sugar workers.	Half are located in ricegrowing areas and one-third in sugar areas. Wife and children often work as wage labor. In rice areas, landless often contract to do weeding in exchange for portion of harvest—freezes out landless from outside village.	In ricegrowing regions, 50 percent of income is typically derived from agricultural employment, 25 percent from secondary sources, and 25 percent from remittances. Sugar workers have limited sources of outside income.	Depend on cash income, but real wages declining because labor competition increasing, labor-saving technologies reducing demand, productivity is low, and inflation increasing cost of living.
	In sugar fields, work performed at flat rate—often below minimum daily wage.		Fluctuating world prices affect sugar and coconut workers.
			Low level of education and skills restricts job mobility.
			Few alternative employment opportunities available.

The agrarian reform program also is disrupting beneficial aspects of traditional tenant-landlord relationships under which the landlord supplies credits or inputs and helps a farmer through bad crop years. A system of rural cooperatives—designed to replace services provided by the landlord—never got off the ground. Landlords have also taken advantage of loopholes in the program to lease land to cooperatives, take land out of rice production, or subdivide land. Disruption in the tenant-landlord relationship has contributed to the breakdown of traditional methods of social conflict resolution—in which the landlord

plays the key role. The Communist insurgents have clearly recognized this breakdown and are exploiting it through propaganda for recruitment purposes.

**Promoting Rice Production.** Manila has had better luck with a rice promotion program called Masagana 99, begun in 1973 to increase production through an

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Table 2 (continued)

	Characteristics	Income Sources	Vulnerability
<b>Upland farmers</b>			
Over 30 percent of rural households; 70 percent classified as poor. Comprises Kaingineros (tribal slash-and-burn farmers) and upland rice and corn farmers.	Over 60 percent are upland rice and corn farmers, growing low-yielding varieties on holdings averaging 3.5 hectares. Mix rice or corn farming with fruit trees, livestock, coconuts, and root crops.	Off-farm and nonagricultural employment provides up to 70 percent of income.	Seasonal income and limited off-farm employment opportunities.
	Indigenous Kaingineros—20 percent of upland farmers—are illiterate non-Christian transient farmers, annually shifting cultivation on 1 hectare in illegally occupied remote rain forests.	Nearly 90 percent of income derived from farming.	Few educational opportunities for children.
	Marginal Kaingineros—20 percent of upland farmers—literate Christian farmers who migrated from lowlands. Practice slash-and-burn shifting cultivation on 1- to 2-hectare plots in accessible forest and grassland.	Nearly 70 percent of income derived from farming.	No secure access to land; competing with other farmers and loggers who do not recognize tribal property rights.  Fertility of uplands diminishing as hills are denuded of forest cover by illegal logging and as pressure on land cuts short the necessary fallow cycle.  Dependent on farm income.
<b>Artisanal or municipal fishermen</b>			
About 15 percent of rural households. Over 80 percent fall below poverty threshold.	Fish inland and coastal waters using small boats ( <i>bancas</i> ). Most own their fishing equipment but rent their boats or hire on to larger boats. Less than 20 percent own a small farming plot.	Supplement income with agricultural or service jobs.	Fishing resources are being depleted.  Rely on middlemen to market fish, but many villages do not have offloading or storage facilities.  Cost of operating motorized <i>bancas</i> rising due to higher fuel prices.

integrated package of subsidized, no-collateral credit from rural banks linked to high-yielding rice varieties, fertilizer, and other inputs. The program was initially a great success, according to the World Bank, and by 1977 the Philippines achieved self-sufficiency in rice, producing 4.2 million metric tons—a 30-percent increase from the 1969-71 average—because of the steady expansion of rice acreage, irrigation, and high-yielding rice varieties.

The program, unfortunately, has benefited a minority of farmers—mainly relatively large and modern farms with access to irrigation and able to finance the program's high-cost inputs. The program's large input costs, moreover, have left many participants deeply in debt. Manila has complicated the picture by aggressively prosecuting farmers behind in payments. By

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1977, over 70 percent of the program's loans were in arrears, disqualifying farmers from fresh credits and severely undermining the soundness of the rural banking system. For these reasons, the program covered two-thirds less riceland in 1979 than in 1973. Moreover, because tenants' rental payments are a fixed portion of the total harvest—often 50 percent—farmers with nonirrigated land are reluctant to make investments that largely provide a windfall profit to the landlord. [redacted]

**The Pork Barrel.** The National Livelihood Program, Kilusang Kubuhayan at Kaunlaran (KKK), began in 1981 with the objective of generating employment and income and reducing regional development disparities by transforming villages and towns into self-reliant production units. The program largely bypasses established government agencies and seeks to motivate private rural enterprise with seed-capital loans for public and private activities benefiting the poor. The US Embassy reports that the program emerged from First Lady Imelda Marcos's political strategies for gaining popular support and her almost mystical development philosophy of self-reliance. Operated by her Ministry of Human Settlements (MHS), the KKK is designed as an economic and psychological panacea for the stagnant rural economy. [redacted]

The program consists of three elements. First, interest-free and 12-percent loans are provided for primary production projects in agriculture, forestry, livestock, and cottage and light industries. Typical KKK-funded activities are piggeries, fruit tree farms, communal fishponds, bamboo furniture workshops, and charcoal and concrete-block production facilities. The second component, larger scale anchor projects, such as food-processing centers, link primary production activities to the program's third element, regional-level marketing and export-processing centers. In a departure from traditional Philippine rural development programs, output from KKK projects is marketed through MHS-controlled agencies—such as the National Food Authority—and KKK projects are implemented with the MHS's field staff with assistance from local governments. [redacted]

Following a highly publicized startup period, the KKK has been stymied by criticism and its own bureaucracy. In its first two years of operation, the KKK disbursed \$92 million for about 280,000 beneficiaries, according to MHS records. In 1984, however,

only \$18 million was disbursed for projects benefiting 18,000 Filipinos and no new loans have been made in 1985. Although some poorer individuals and villages have benefited from the program, the World Bank believes that the KKK is making no lasting contribution to rural development, and, by draining funds from other ministries, it may actually retard development. Several leading Philippine economists believe that the KKK should be scrapped because it is too costly—during its first 18 months, administration costs equaled loan disbursements—and because loan recipients are selected primarily because of their ties to the ruling party. Repayments are low—less than 20 percent of the KKK loans are being repaid, and many KKK investment projects are not financially viable and have closed down. [redacted]

#### **The Political Football of Pricing Policies**

Rural development has been sharply retarded by the government's pricing policies—which, in our judgment, remain Manila's most important policy mistake. [redacted]

**Exchange Rate Management.** Exchange rate management is a longstanding problem and illustrates government misuse of its most powerful pricing instrument. Philippine economists estimate that by 1982 the peso was overvalued by more than 30 percent because Philippine inflation regularly exceeded price increases of trading partners. As a result, Philippine exports became less competitive on the world market and resulted in lower peso earnings for Philippine exporters. The overvalued exchange rate has hurt rural producers by lowering revenues they would otherwise earn from agricultural exports and by encouraging domestic manufacturers to buy raw materials and inputs from overseas, rather than domestic producers. [redacted]

**State-Sanctioned Monopolies.** Manila's institutional arrangements—including pricing, tax, tariff policies, and marketing monopolies—have dramatically subsidized urban consumers and taxed agriculture. Manila's primary objective has been to keep urban food

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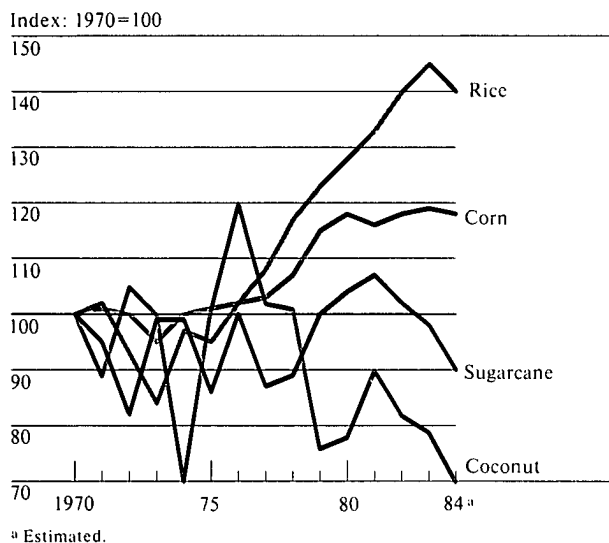
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**Figure 5**  
**The Philippines: Index of**  
**Agricultural Yields, 1970-84**



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prices at politically acceptable levels. Intervention in agricultural marketing by government agencies and privately owned marketing monopolies does so, but discourages investment in agriculture by keeping prices received by farmers—and thus profits—lower than would be the case if market forces were allowed free rein. As a result, Philippine agricultural productivity is low compared with other Asian countries and is decreasing, according to the World Bank.<sup>3</sup>

**Coconut.** Coconuts generate between 15 and 20 percent of Philippine export revenues and account for about 20 percent of total agricultural crop production. The Agency for International Development estimates that about one-third of all Philippine households derive some income from coconut and related byproducts. In the principal growing regions of the Visayan Islands and northern Mindanao, coconuts provide over 60 percent of the cash income earned by farmers. AID estimates that the real income for coconut farmers has dropped nearly 50 percent since 1979,

<sup>3</sup> In 1983 average yields for rice in the Philippines were 2.3 metric tons per hectare, compared with 3.4 tons in Indonesia, 3.1 tons in Burma, and 2.9 tons in Malaysia.

and the US Embassy reports that the coconut monopoly controlled by Eduardo Cojuangco—Marcos's longtime political ally—is partially responsible because of monopoly pricing practices. Moreover, coconut farmers complain that they have not benefited from the insurance and scholarship programs that the coconut marketing monopoly claims to be providing. According to AID studies, basic marketing and pricing reforms could boost farmers' income by about one-third. Coconut prices have plummeted so low this year—because of declining world prices—that farmers are not making a profit.

Cojuangco and his associates control the industry through its governing body, the Philippine Coconut Authority (PCA); the United Coconut Oil Mills (UNICOM), which controls 94 percent of the country's copra crushing capacity; and the industry's leading bank, the United Coconut Planters Bank (UCPB). Presidential decrees grant UNICOM a monopoly over coconut exports and give Cojuangco's United Coconut Chemicals a monopoly over private-sector production of coconut-based chemicals.

Substantial reforms of the industry are on hold, however. Instead of consulting with the World Bank on a comprehensive set of reforms—as previously agreed—Marcos last winter unilaterally announced a reorganization of the coconut industry along with regulations governing export taxes on coconut products. The reorganization allows coconut mills to bypass UNICOM and export their own product. According to the US Embassy, however, Marcos's announced return of coconut trading to the private sector is widely viewed as lipservice to suggestions by the IMF and aid donors, partly because the export of unprocessed coconut remains banned.

**Sugar.** Sugar's contribution to the country's foreign exchange earnings peaked at 27 percent in 1974 but declined to about 8 percent in recent years. Depressed world sugar prices—down to 4 cents a pound from over 30 cents in 1980—and declining production are aggravated by political favoritism and corruption in the sugar industry, which has been run since 1977 by Roberto Benedicto, a longtime Marcos associate. Benedicto's power derives from his control over the policy-setting Philippine Sugar Commission



(PHILSUCOM), the National Sugar Trading Company (NASUTRA) marketing monopoly, industry financing from his Republic Planters Bank, and the cane-crushing mills owned by his Philippine Sugar Corporation. [ ]

According to the US Embassy, Benedicto's total control over sugar marketing and pricing—aided by legal provisions shielding NASUTRA from audit—have allowed him and his associates to reap enormous profits. For example, in 1984 sugar stocks worth more than \$130 million were missing from NASUTRA's warehouses and NASUTRA earned \$22 million in interest by delaying payments to sugar growers. In addition, the US Embassy reports that Benedicto has made more than \$1 billion in the last few years by trading with overseas sugar brokers he controls, helping him to acquire more than 50 corporations. [ ]

Marcos's recent reorganization of the sugar industry—following pressure from the aid donors, Philippine business leaders, and many sugar growers and millers—sparked a bid by Cojuangco to join disgruntled growers and millers to wrest control of the industry. The reorganization changes PHILSUCOM into a commission elected by planters and growers and changes NASUTRA into a privately owned firm run by a manager elected by the commission. Marcos blocked any chance of meaningful reform by choosing election rules for the new commission so biased in favor of Benedicto that Cojuangco's slate withdrew. An official of the World Bank—Manila's largest aid donor—told US Embassy officials that Marcos's proposed reforms in the sugar industry are meaningless as long as Benedicto or his associates head the commission [ ]

#### Options for the Future

Well-publicized economic studies by Philippine academics and business organizations have concluded that a better climate for investment is required to cope with rapid labor force growth and that agricultural reform is required to slow the expansion of the Communist insurgency. Essentially, the debate over agricultural policy continues to be a contest between a comprehensive action plan and incrementalism. [ ]

**A Comprehensive Action Plan.** Manila's aid donors—supported by the majority of business leaders, academics, and opposition politicians—believe that sustained structural adjustment and major economic

policy changes are necessary to stimulate economic growth and rural development and to improve income equality. Their published positions indicate that proponents of this strategy also assume that Manila will carry out military reforms and a counterinsurgency program to improve security throughout the countryside. [ ]

The plan requires that Manila deregulate the prices of agricultural commodities, such as rice and corn, and free rural credit and input markets—with special emphasis on dismantling the sugar and coconut monopolies. Furthermore, Manila and its aid donors are seeking to reallocate government expenditures into the rural economy for such items as agricultural research, essential rural public works, and social services. In recent years, over 40 percent of the government's investment program has benefited Metropolitan Manila but has curtailed funding in rural areas for maintenance and personnel—an approach that allows previous investments to deteriorate and social services to decline. [ ]

We believe that the comprehensive approach would improve agricultural output and rural incomes, boosting annual rice and corn production by 4 percent, allowing the rural economy to grow by over 4 percent annually—versus about 1.5 percent at present—and ensuring that these gains are translated more evenly to smallholder farmers and the landless. With a broader recovery of the national economy, this growth rate could be expected to rise even further. Moreover, the World Bank expects that pricing reforms, an exchange rate that does not penalize exporters by overvaluing the peso, and reduced government intervention in agricultural marketing will provide significant incentives for rural producers and investors. If the private rural sector responds to these actions and improved security in the countryside, investments in irrigation and new inputs are expected to increase yields and encourage a diversification of export crops. Furthermore, higher crop prices will increase farmers' incomes and support a higher level of rural consumption. [ ]

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**Table 3**  
**The Philippines: Economic Reforms**

Policies and Instruments	Expected Benefits	Remarks
<b>Trade policies:</b> <ul style="list-style-type: none"> <li>• Lower tariffs.</li> <li>• Float exchange rate.</li> <li>• Decontrol foreign exchange allocations.</li> </ul>	Eliminate trade deficit. Stimulate export growth and allocate resources more efficiently. Nontraditional exports could increase by 9 percent annually; industrial output, by 5 percent annually.	Central to ongoing World Bank structural adjustment loans (SALs), and IMF standby. Impact of SALs I and II—providing \$500 million beginning in 1980—diluted by presidential decrees granting exemptions to Marcos's associates.
<b>Fiscal policies:</b> <ul style="list-style-type: none"> <li>• Widen tax base, abolish distortionary taxes, and raise efficiency of tax collection.</li> <li>• Cut expenditures.</li> <li>• Prioritize investments.</li> <li>• Increase utility fees.</li> <li>• Reform public-sector corporations.</li> </ul>	Balance government's budget, reduce reliance on foreign borrowings, and trim inflation. Establish public expenditure pattern consistent with long-term growth objectives. Eliminate subsidies to public-sector corporations.	Fundamental to the IMF adjustment program. Additional fiscal policy reforms planned for the World Bank's 1986 SAL III. Marcos and the ruling elite oppose budget cuts in favored programs and ministries as well as suspension of tax exemptions granted to close associates. Public is unhappy over increased utility fees for water, electricity, irrigation, and fuel.
<b>Agricultural policies:</b> <ul style="list-style-type: none"> <li>• Decontrol input and farm-gate prices.</li> <li>• Decontrol crop marketing, especially in coconut and sugar.</li> <li>• Increase rural credit.</li> </ul>	Raise agricultural output to over 4 percent annually by 1987, with growth rates of 4 percent for coconuts and rice.	Focal point of reforms advocated by World Bank and aid donors. Imelda Marcos and some technocrats favor continued government intervention in agricultural marketing, especially with the NFA.
<b>Financial institutions:</b> <ul style="list-style-type: none"> <li>• Rehabilitate government-owned financial institutions, limiting new loans and improving loan collections.</li> <li>• Merge and consolidate weaker private banks.</li> </ul>	Strengthen financial sector and restore public confidence in banking system. Reduce reliance on foreign savings by raising domestic savings rate.	Action plan for financial reforms required by IMF. Lending limits on government-owned banks resisted by technocrats favoring continued government acquisition of businesses and by ruling elite seeking financial bailouts.
<b>Government decisionmaking:</b> <ul style="list-style-type: none"> <li>• Limit use of presidential decrees for setting economic policy.</li> </ul>	Greater accountability and participation in policymaking. Reduced government intervention in economy; fewer special favors to Marcos's associates.	One of the key political reforms sought by opposition parties, business community, and aid donors. Marcos is strongly resisting efforts to curb his decree-making authority.

**Incrementalism.** Alternatively, Marcos could continue pursuing an incremental approach to rural development and reform, combining ongoing programs with ad hoc efforts—such as the National Livelihood Program or this year's crash rice production effort—and selected policy reforms. Indeed, Manila's recent "Agenda for Action in Agriculture 1984-1988" outlines a rural development strategy that largely continues existing programs and remains silent on such issues as land tenure or the landless. Although we believe better management of Manila's development programs could increase agricultural output and improve rural social services, according to AID reporting, only marginal gains are possible because many

government institutions have lost credibility with the public and government middle managers are demoralized. [ ]

The economic impact of continued incrementalism is easy to predict. We believe that agricultural output would be hard pressed to keep pace with the country's projected 2.3-percent annual rate of population growth, and traditional agricultural exports, such as coconuts and sugar, would stagnate or decline. Under

this outcome, our econometric analysis suggests that in 1990 per capita consumption will be 20 percent lower than in 1983 for farmers as well as urban workers in manufacturing enterprises. [redacted]

#### The Outlook for Change

No matter what course Marcos follows, the agricultural outlook will get worse before it gets better. The Philippine debt crisis and the IMF-mandated economic adjustment program—designed to improve the balance of payments, reduce reliance on foreign borrowing, trim the government's budget deficit, and lower inflation—is hurting the rural economy over the short term.<sup>4</sup> Although the peso's 53-percent devaluation since early 1983 will raise revenues earned by Philippine exporters and help agriculture as a whole, small-holder farmers do not produce crops for export, and their input costs have climbed. Prices of fertilizer—largely imported—are up 30 percent, and high interest rates—a result of tight monetary policies—are driving up the cost of production loans. One effect is that rice farmers are reportedly switching to lower yielding varieties that require fewer purchased inputs—aggravating a rice shortage expected in 1985.

[redacted]

Over the longer run, the outcome will depend on economic policy, which will in turn reflect Marcos's political calculations. Manila will probably adopt a mixture of some reforms demanded by its creditors and incrementalism dictated by the ruling party's political needs. One thing is clear. Pressures from the aid donors and domestic critics will not easily change Marcos's business-as-usual attitude toward the rural economy or his habit of temporizing on economic reforms. Marcos [redacted] continues to deny the full scope of the Communist insurgency and the depressed state of the rural economy. He is not seized with the need to implement a comprehensive program of economic policy reforms, agrarian reform, or effective counterinsurgency.<sup>5</sup>

[redacted]

<sup>4</sup> The US Embassy reports that Manila's efforts to coordinate civil and military counterinsurgency are stalled by political infighting and Marcos's insistence that he take personal control of the program. We believe that the military's ideas for enhancing economic development in NPA-controlled areas—including improving roads, public buildings, and irrigation systems—are insufficient to address deep-rooted grievances or shake many villagers' commitment to the NPA. [redacted]

On the political front, however, an incremental strategy toward policy reform permits Marcos to maintain the structure of "crony capitalism"—the granting of loan guarantees, waived import taxes, and monopoly privileges—and avoids an admission that his New Society development programs are failing. "Crony capitalism" financing is particularly critical to the New Society Party (KBL), the ruling party, and underwrites the campaigns of favored politicians. Marcos undoubtedly understands that favoritism in economic policy is the most likely way to ensure that the portion of the business community willing to finance politics remains loyal to him, leaving opposition politicians without an adequate flow of funds.

[redacted]

For their part, the World Bank and IMF, with support from Manila's largest bilateral aid donors, appear determined to link increased future assistance to progress on economic reform. In addition, Manila's commercial creditors are tying new financing to Manila's compliance with the targets and reforms of the IMF program. The government's sidestepping of significant economic restructuring so far suggests a lengthy confrontation between Manila and its aid donors and has already prompted some donors to withhold or reduce new aid pledges. [redacted]

Even if Marcos agrees to initiate a comprehensive rural development effort, he faces several handicaps. For one thing, weak local administrators—fearing the NPA—hamper a comprehensive rural development effort. Over 100 local officials were reportedly killed by the NPA last year, and, as a result, an increasing number are making some form of accommodation with the NPA or are simply permanently absent from their offices. The US Embassy reports that in some areas of Mindanao the government has insufficient control and presence to undertake any rural development program. [redacted]

Many benefits from the reforms that do take hold will not be realized until the end of this decade. According to World Bank project evaluations, effective development programs take years to design and implement. Additionally, budget restrictions—currently mandated by the IMF's economic adjustment program—rule

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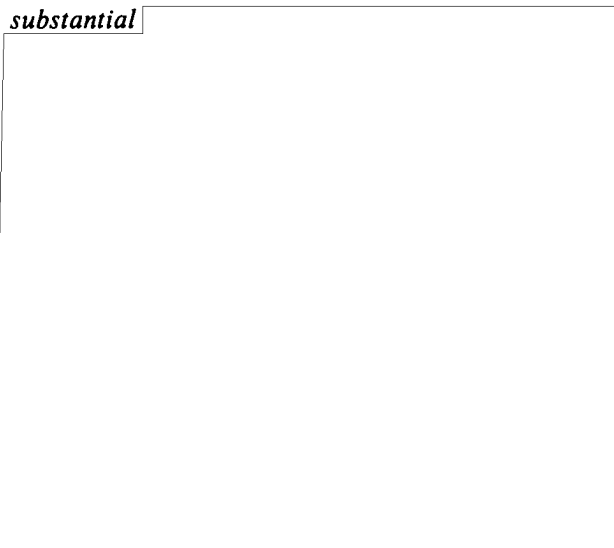
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*Economic Impact of the Insurgency*

*Ironically, the NPA has now taken sufficient root in many areas that it is retarding economic recovery in the countryside by undermining investor confidence and business profits—a reality that magnifies the imperative of economic reform. The NPA taxes collected from poor farmers are generally modest—equivalent to 25 cents plus one can of rice a month. Taxes levied on rural businesses, however, can be substantial*



*NPA sabotage during the last three years destroyed rural investment valued at \$25 million. [redacted] Downed powerlines, for example, have left much of southern Negros without electricity for over a year, closing a large copper mine, several sugar mills, and other small businesses. Rural sabotage and attacks on military units are contributing to an increase in absentee businessmen, according to US Embassy reporting. For example, a major Philippine bank recently ceased making new loans in Davao—where insurgents have been intensifying operations since 1980. [redacted]*

out any dramatic spending increase for rural development. The Agriculture Minister, for example, recently admitted that budget limitations threaten the credit programs for rice and corn production that were recently announced by President Marcos. Furthermore, spending prior to local elections scheduled for 1986 is likely to divert funds away from rural programs [redacted]

*In areas where the NPA is active, government officials report that their tax collections are falling, and social services are being trimmed as a result. In one region of Samar, property tax collections fell to \$340 this year from the \$4,500 previously collected—with most of the difference reportedly paid to the NPA. In another area of Samar, one-half of the villages paid no property taxes to the government, yet property taxes often account for 20 percent of a local government's revenues. Because increased NPA collections appear to be at the expense of local government revenues, they are reducing significantly funds available for social services and aggravating complaints about inadequate government services. Heightened NPA military operations, moreover, force local governments to increase their spending on defense forces and drain their social services budget further.*



*We believe that the NPA's tax collection, intimidation, and sabotage tactics will retard the rural economic recovery sought by Manila and its aid donors. In Davao, the NPA is disrupting the local economy by increasing its tax collection, reducing the government's influence, and increasing confrontations with the military. Furthermore, the NPA has begun to target rural development programs.*

*[redacted] If rural incomes do increase because of free market pricing policies enacted by Manila, the NPA—with its extensive tax and food collection efforts—may be the initial beneficiary, not the government. [redacted]*

We believe that under these circumstances per capita income in rural areas will still be 10 percent lower in 1990 than in 1983. In this case, the majority of the rural population will continue living in poverty at the end of the decade and remain receptive to NPA propaganda [redacted]

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